Michael K. Jeanes, Clerk of Court
*** Electronically Filed ***
08/17/2007 8:00 AM

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2006-050010 08/14/2007

HON. THOMAS DUNEVANT, III

CLERK OF THE COURT
L. Nixon
Deputy

RIGEL CORPORATION

PETER C GUILD

v.

STATE OF ARIZONA, et al.

MICHAEL F KEMPNER

UNDER ADVISEMENT RULING
(PLAINTIFF, RIGEL CORPORATION'S, MOTION FOR PARTIAL SUMMARY JUDGMENT AND DEFENDANT, STATE OF ARIZONA'S, MOTION FOR PARTIAL SUMMARY JUDGMENT)

Rigel Corporation, prior to its bankruptcy filing, was the Phoenix area franchisee for Krispy Kreme doughnuts. It operated several restaurants at which customers could either sit and eat doughnuts or purchase doughnuts to eat at home, the latter constituting the larger share of sales. The Department of Revenue assessed transaction privilege taxes on Rigel's sales, both those for consumption on the premises and those for take-out. Rigel sought a refund for the tax paid on its take-out sales through the proper administrative procedure, and receiving no relief brought suit in the Tax Court. The primary issue presented is whether Rigel was a qualified retailer eligible for the tax exemption on food sales pursuant to A.R.S. § 42-5102. Whether sales through the drive-through windows are exempt and whether the Department of Revenue's taxation policy infringed upon Rigel's constitutional guarantee of equal protection are also raised.

The Court observes that it is immaterial how much "soul searching" the Department of Revenue may have done in considering whether and under what conditions bulk sales of doughnuts should be exempt from sales tax. While the length of time spent in consideration suggests that there is merit on both sides of the issue, this does not reduce the level of deference that the Court must grant the interpretation the Department ultimately reaches. *Arizona Water Co. v. Arizona Dept. of Water Resources*, 208 Ariz. 147, 154 ¶ 30 (2004). The Court is bound by

the statutory language. That Rigel does not qualify for exempt status because it sells too many doughnuts for take-out relative to on-premises consumption may seem to illustrate a flaw in the statutory scheme, but it is not this Court's prerogative to take the "macroscopic" perspective as Rigel suggests. It must abide by what the legislature has said.

Rigel is correct that "food" as used in A.R.S. § 42-5102 means "any food item intended for human consumption which is intended for home consumption," as distinguished from "food for consumption on the premises." (There is no dispute that doughnuts are food intended for human consumption.) Rigel first argues that it is entitled to the exemption in A.R.S. § 42-5102(A)(2) applying to retailers whose primary business is not the sale of food for home consumption. However, most of Rigel's sales (the parties variously cite figures of 92 percent or "in excess of" 75 percent) were doughnuts intended for home consumption; even using the lower figure, it is clear that Rigel's primary business is the sale of food for home consumption. By its plain language, then, section 5102(3) does not apply. Rigel cites an internal Uniformity Committee memorandum of December 27, 1999, in which the situation of Dunkin' Donuts was considered. The author of the memorandum states that "Dunkin' Donuts' primary business is not the sale of food for home consumption. However, Dunkin' Donuts sells donuts and muffins for home consumption," and goes on to conclude that the doughnuts and muffins "may qualify for the exemption" because they are sold in a similar manner as at an eligible grocery. Rigel reads too much into this memorandum. It appears that Dunkin' Donuts was used, as were Starbucks and Marie Callender's, as a hypothetical example, and it is not clear whether the conclusion about its primary business was based on specific information received from Dunkin' Donuts or was merely used to illustrate the underlying principle. The memorandum does not seem to have served as the basis for the actual tax assessment of Dunkin' Donuts. But even if it was, and even if then-Director Killian's directive to interpret the statute in accordance with that memorandum remains effective seven years after its "provisional" issuance, it still does not benefit Rigel, because Rigel's primary business *is* the sale of food for home consumption. Rigel has not shown that Dunkin' Donuts or other doughnut sellers were in fact taxed differently when their actual ratios of home versus on-premises consumption were the same.

The statutory language is clear: only six enumerated classes of sellers are exempt from the sales tax on food. Ms. Cheatham's opinion that the legislature intended to exempt all bulk sales of food does not square with the statutory scheme. Were that the design, and if for some reason the legislature did not choose to say simply "all bulk food sales are exempt from transaction privilege tax," the obvious complement to "a retailer … whose primary business *is not* the sale of food" would be "a retailer whose primary business *is* the sale of food." (This language would obviate the need for at least three of the remaining classifications, though vending machines might still require separate treatment.) The legislature did not do this. Instead, its complement is "a retailer who conducts an eligible grocery business," which it goes on to define as one eligible to participate in the federal food stamp program. A.R.S. § 42-

5101(1). The structure enacted by the legislature leaves a gap: retailers whose primary business is the sale of food but who are ineligible for the food stamp program and who do not fit any of the other exclusions. This gap cannot be explained away as an oversight: for whatever reason, the legislature insisted on food stamp qualification as a requirement for an exempt grocery business, and granted no exemption to food retailers who would be exempt grocery businesses but for their inability to participate in the food stamp program. Nor may the gap be ignored by creatively construing the other exemptions. The proposal of October 25, 1999 to expand the meaning of "delicatessen" falls here. A delicatessen is defined in A.A.C. R15-5-1860(5) as "a business which sells specialty food items, such as prepared cold meats, perishable food and grocery items kept under refrigeration." At least since 1999, and for some time before that, the Department has interpreted "delicatessen" to exclude doughnut and ice cream shops. Having concluded that it was anomalous for taxation of a food item to depend (because of the gap) on the character of the seller rather than the product, the proposal to include doughnut and ice cream shops within the definition of "delicatessen," not because the existing definition was incomplete or inconsistent with legislative intent, but because an expanded definition would make the taxation of food seller-neutral, at least where on- and off-premises consumption could be segregated. Whether or not the Department could properly have used its authority to redefine "delicatessen" so as to undo the gap created by the legislature is not at issue: the fact is that it did not. Where neither the legislature nor the Department of Revenue has acted, the Court may not.

Rigel plainly falls into the gap. It does not assert that it was a grocery business eligible to participate in the food stamp program (subsection 1), or that it conducted its sales through pushcarts (subsection 5) or vending machines (subsection 6). It does not dispute that it provided facilities for consumption of food on the premises, disqualifying the restaurants at least from exemption under subsection 3 (the Court addresses the drive-through windows later in this ruling). As explained above, it was not a business whose primary business is not the sale of food, disqualifying it from exemption under subsection 2, no matter how similar its sales may be to those of an eligible grocery. The exemption in subsection 4 for separate cash registers expressly applies only to delicatessens, and under the regulation Krispy Kreme was not a delicatessen. As none of the exemptions applies, Rigel was subject to transaction privilege tax on its sales.

Rigel attempts to distinguish sales through the drive-through windows from those of the restaurants. The Court accepts that drive-through sales were recorded separately from inside sales; however, this makes no difference. As noted above, the separate cash register exemption applies only to delicatessens, and the drive-through windows no more qualified as delicatessens than did the restaurants. By its nature, a drive-through window has no tables and chairs. Rigel, however, overlooks that the statute requires the absence of facilities, not only from the drive-throughs, but from "the premises." However rigidly drive-through sales were kept separate from inside sales on Rigel's books, there was no physical division sufficient to create two distinct

"premises." (No statute defines "premises" in any relevant sense; indeed, the Supreme Court has noted that the term is fluid and depends on the situation and purpose of its use. *State v. Sanchez*, 128 Ariz. 525, 528 (1981). It seems evident that a Krispy Kreme store, with a counter, dining facilities, and a drive-through window sharing a common building and a common kitchen, constituted such a logical whole as to form a single premise. *See In re One 1970 Ford Van*, 111 Ariz. 522, 523 (1975) (term "premises" includes property that constitutes a logical part).) Because there were dining facilities on the same premises as the drive-through windows, window sales did not qualify for exemption under subsection 3.

The October 1, 2001 information letter, characterized incorrectly by Rigel as an "administrative ruling," is not binding, as the bold-face disclaimer at the end of the letter made clear. As the disclaimer went on to say, the accuracy of the advice depended upon the accuracy and adequacy of the information submitted. Contrary to the requirement of A.R.S. § 42-5105 that the inquiry state with specificity the facts involved in the question, Ms. Pederson's letter left out a great deal of relevant information, such as the presence of facilities for dining on the premises. The information letter is couched in vague terms: "businesses subject to tax under the restaurant classification *may qualify under certain limited conditions*" (emphasis added). It only cursorily identified those conditions, and did not state that Krispy Kreme satisfied any of them. This can hardly be construed as a definitive ruling that bulk Krispy Kreme sales were exempt from tax.

Rigel has presented no evidence besides an information letter to an unidentified doughnut and coffee seller in 1999 that other similarly situated doughnut shops – i.e., those whose primary business was determined to be sale of food for home consumption – were taxed differently from Krispy Kreme. (As noted above, the Uniformity Committee memorandum of December 27, 1999 does not evidence that Dunkin' Donuts actually received the tax treatment envisioned, and is moreover based on the premise that Dunkin' Donuts' primary business, unlike Rigel's, was not the sale of food, a distinction critical under the statute.) A violation, either of the Fourteenth Amendment guarantee of equal protection or of the Uniformity Clause of the Arizona Constitution, requires that differences in taxation result from intentional and systematic conduct by the taxing authority. *Aida Renta Trust v. Dept. of Revenue*, 197 Ariz. 222, 236-38 (App. 2000). Assuming that the anonymous doughnut shop received an undeserved tax break in 1999, this does not entitle Rigel to the same treatment.

THEREFORE, IT IS ORDERED,

1. Plaintiff's Motion for Partial Summary Judgment is denied.
2. The Department of Revenue's Motion for Partial Summary Judgment is granted.